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DEPARTMENT OF STATE

BRIEFING PAPER

TRADE AND ECONOMIC RELATIONS

The Problem

During the Secretary's October visit to Peking, we made some proposals for forward movement in our trade and economic relations (settlement of the claims issue, trade exhibits, perhaps maritime and civil aviation agreements). We explained that we were interested in such steps for political rather than economic reasons: they would demonstrate in a visible way some forward movement in our bilateral relationship. The Chinese reaction made it clear that at this stage in our relationship, they do not want to take any steps which would demonstrate forward momentum and help to institutionalize our trade/economic relationship at the governmental level.

It is unlikely the Chinese will raise this subject. Given their negative position, and our need to avoid appearing over-eager, we should not initiate a detailed discussion of this subject, although a passing comment could be included in any general remarks on our bilateral relations. In that connection, you could mention your meeting in September with the Chinese delegation representing the China Council for the Promotion of International Trade.

Background

Despite the lack of any institutionalized framework, our trade with the PRC has been one of the most active and visible areas of our bilateral relationship. Starting with a negligible \$5 million in 1971, two-way trade grew to \$100 million in 1972 and then, beyond all expectations, exploded to \$805 million in 1973 and \$1,070 million in 1974. The spectacular growth in 1973 and 1974 was due

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primarily to large PRC purchases of US grain, soybeans, and cotton made necessary by a bad harvest in 1972. (More than 80 percent of our exports to the PRC in 1973 and 1974 consisted of agricultural products.) The heavy PRC agricultural purchases resulted in a trade imbalance in our favor of about 11/1 in 1973 and 7/1 in 1974.

Because of improved harvests, commitments under grain agreements with Australia and Canada, and balance of payments problems, the Chinese have not bought any agricultural products from the US in 1975. As a result, total bilateral trade will be down substantially this year to an estimated \$450 million, and the trade imbalance will be reduced to less than 3/1.

Since 1972, non-agricultural trade has been increasing steadily but unspectacularly, with the US exporting high-technology items (including Boeing 707's and large chemical fertilizer plants) and importing miscellaneous consumer items, semi-processed goods and raw materials.

In strictly economic terms, US-PRC trade is not significant to us: even in the peak year of 1974, it constituted less than one-half of one percent of our total world trade. The Chinese, on the other hand, derive substantial economic benefit from our trade. Last year, the US was the PRC's second largest trading partner, and we will probably remain an important supplier to the PRC of high-technology manufactures and a residual source of grain when its needs are not met by its traditional suppliers (mainly Australia and Canada).

Both the level and composition of our trade is largely determined by the PRC. The Chinese have made it clear by their behavior that they wish to retain maximum freedom of maneuver in the US market and have studiously sought to minimize US governmental involvement in trade matters.

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The Chinese occasionally tell American visitors that the full potential for trade cannot be realized until political relations are normalized. This is certainly a factor in those areas which require intergovernmental agreements (such as a claims settlement and civil aviation links), and it may affect some decisions on how much they will buy from the US. However, economic considerations--dictated ultimately by Chinese development objectives--are also an important determinant. Even if political relations were normalized, the level of trade probably would not automatically make a large jump.

The Chinese are embarking on an ambitious economic development program which was first outlined by Chou En-lai at the National People's Congress early this year. To achieve their goals, the Chinese have had to decide how much they will depend on foreign technology. The issue of self-reliance vs. importing foreign technology is a sensitive one in the PRC: the Chinese have a strong ideological tradition of self-reliance, reinforced by their experience with the Russians. In the context of their current development objectives, however, the Chinese appear to have decided to make use of foreign technology on a limited, selective basis. When it is in their economic interest, the Chinese have, and will, turn to US technology, particularly in areas where US manufacturers are competitive or have something unique to offer.

Judging from several new departures they took this year, the Chinese remain interested in promoting and facilitating US-PRC trade, although within the limits imposed by their political considerations. The most visible step was the first visit to the US of a delegation from the China Council for the Promotion of International Trade (CCPIT). You met with the delegation in September. Little was achieved during this visit

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toward institutionalizing the trade relationship on a non-governmental level--much to the disappointment of the hosts, the National Council for US-China Trade (NCUSCT). The visit received good publicity, however, including articles in Fortune and Business Week. The CCPIT delegation did indicate during their visit that the PRC would be amenable to a return visit by the NCUSCT next year (which was agreed to during Secretary Kissinger's visit in October) and that the PRC would consider proposals for trade missions put forward by the NCUSCT. In other departures this year, the Chinese invited organized US trade delegations to the PRC, sent representatives of their foreign trade corporations to the US for market surveys, began accepting contracts in US dollars, invited substantially larger numbers of American businessmen to the Canton Fair, and developed limited ties with major US banks.

The most useful immediate step which could be taken to improve US-PRC trade/economic relations would be to settle the claims issue; this would be highly visible and therefore politically symbolic, and would also remove an obstacle to some other steps. However, the discussions during Secretary Kissinger's visit in October indicate that the Chinese are not prepared to conclude an agreement now. Nevertheless, because of the importance and complexity of this issue, it is covered more fully in a separate paper. The remainder of this background section discusses several other specific issues.

Most Favored Nation Treatment. We have consistently taken the position with the Chinese that we are prepared to discuss an agreement extending MFN to the PRC in exchange for comparable benefits for us, but only after settlement of the claims/assets issue. The Chinese for their own reasons, have not pressed us on the matter at authoritative policy levels, although lower level officials occasionally mention the MFN issue to American businessmen as an example of

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US-imposed obstacles to trade. Negotiating a trade agreement with the PRC that will meet the requirements of the 1974 Trade Act will be difficult under the best of circumstances, and the Jackson/Vanik language on emigration adds a further major complication.

Export Control. The Chinese have not raised the question of US controls with us directly, but we know that they remain sensitive to the existence of the program. We apply the same export control criteria to the PRC as we do to the USSR and Eastern Europe. The Chinese have generally been reluctant to provide the end-use information required by US regulation, i.e., detailed information on how the item will be used, adequate to justify a conclusion by the USG that there is a legitimate civilian need for that item and that there is little likelihood that it will be diverted to a military use. Moreover, unlike the Soviets, they have refused to fill out USG forms. The Chinese have begun to provide some limited end-use information by means of a letter to the exporting firm, particularly for types of equipment uniquely available from the US. We have been provisionally accepting these letters in lieu of the more rigorous procedures that we require from the USSR.

Recently, the Chinese have been negotiating with several US companies (Burroughs, Control Data Corporation, and IBM) to purchase their top-of-the-line computers. We have licensed smaller machines for the USSR only under the most stringent controls involving resident US personnel and regular inspections. In contrast, the Chinese have yet to agree to sign an end-use statement, although they have hinted that in the case of the large computer, they might be willing to go that far. On September 23, the Export Administration Review Board turned down an application by Burroughs to sell to the PRC a computer far more sophisticated than any that have been previously licensed for export to the USSR or any other communist country.

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Cotton Textiles. The PRC is the world's largest producer of cotton textiles and a substantial part of China's exports consists of fabrics and clothing. After entering the US market in 1972, the PRC had become our fifth largest supplier of cotton textiles by 1974. Although PRC textile imports are down in 1975 due to the recession, there are indications that substantial orders are being placed in the PRC for delivery to the United States in the spring of 1976.

At present there are no US restrictions on textile imports from the PRC. Our domestic textile industry views PRC textile imports as a potentially serious threat and has begun calling for steps to control the PRC's potential for disrupting US textile markets. Several countries with which we have bilateral restraint agreements for textiles have also informally raised with us the question of PRC textile imports. Under the multilateral agreement on textiles we have an obligation to insure that we will not treat countries that have not signed bilateral agreements with us more favorably than those that have.

We raised the question of textiles with the Chinese in August, 1972 and again in the spring of 1973. The Chinese reacted stiffly to the suggestion that we might have to impose restraints on their textiles. Earlier this year we reminded a PRC textile delegation visiting the US of this potential problem.

We are likely to come under increasing pressure from the domestic industry and our trade partners to address the question of PRC imports. We are currently considering what our next steps should be.

Fluor Refinery Project in Hong Kong. Fluor Corporation, a large, reputable engineering firm that has negotiated a number of projects overseas, has proposed to the Chinese a project for a huge petrochemical/refinery complex in Hong Kong that would be owned by the PRC through a front group of Hong Kong businessmen. The proposal entails a

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complex arrangement whereby the FRC would supply the crude and buy back most of the product, leaving about 15 percent to be marketed by the consortium of US banks which would finance the project. Fluor is convinced that the project is technically sound and that the FRC is very interested.

Our assessment has been complicated by the highly unusual manner in which the Fluor-PRC negotiations have been pursued, and by the highly dubious claim of one of the American negotiators that the Chinese are using him as a channel to pass political messages to us. However, the project has elements of plausibility and might conceivably be attractive to the PRC, although it would mark a major new departure in the FPC's policy on developing its petroleum resources. Hong Kong and British authorities have been cautiously favorable to the project, but have major reservations about the front group in Hong Kong and the seriousness of PRC interest.

The US participants have intimated that high level Chinese leaders may mention the project during your visit. While this would help to clarify the degree of PRC interest in the project, we consider it highly unlikely that the Chinese would first choose to broach the subject officially to us at your level. If they do, you could say you have heard something about the project and suggest it be discussed, if they wish, at a lower level.

Chinese Position

It is unlikely that the Chinese will raise trade and economic matters. They appear satisfied with the development of our economic relations to date but link any progress in institutionalizing our commercial ties to further normalization of relations. Although they want IMF, the Chinese are probably not willing to negotiate the required bilateral agreement at this time. They do not like our export controls, but do make some adjustments to them when they see it in their interests. The Chinese will object strongly to any suggestion that restraints be placed on their textile exports to the US.

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US Position

As noted earlier, we should not initiate a discussion of trade matters. Our primary interest in our trading relationship with the PRC at this stage is political--i.e., we see continued growth in the volume of trade and continued progress in institutionalizing our commercial relations as useful symbols of forward progress in our relations. We would like to move forward in such areas as trade exhibitions, banking, shipping and aviation, but are precluded from doing so by the lack of progress on the claims/assets issue and by apparent Chinese political constraints. We are prepared to extend MFN to the Chinese at an appropriate time after the claims/assets issue is settled. We have dealt fairly with the PRC on export controls and treat them on the same basis as we do the USSR. PRC cotton textile exports to the US represent a potential problem and eventually we may have to put restraints on them.

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